FILE COPY

FILED
MAR 18 1931
CHARLES ELMORE CRO
CLE

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

---

BRIEF FOR PETITIONER

C. R. DEWEY,
HENRY T. DORRANCE,
Counsel for Petitioner
UTICA, NEW YORK.

INDEX

	Page
OPINIONS BELOW	1
JURISDICTION	1
STATEMENT OF CASE	2
SPECIFICATION OF ERRORS	4
OUTLINE OF ARGUMENT	4
ARGUMENT	6
POINT I—The petitioner is expressly entitled by the provisions of Section 214(a)(7) of the Revenue Act of 1926 to deduct from income as a bad debt his share of the notes of the Electric Refrigeration Co. Inc., which he acquired, ascertained to be worthless and charged off in 1925, for	6
(a) On payment to the bank, the petitioner and Ainsworth became owners of the notes of the corporation which they had a right to enforce against the corporation	6
(b) The notes thus acquired were ascertained to be worthless in 1925, and were charged off in that year	8
POINT II—The arguments of the learned Solicitor General, some of which were approved by the lower Courts, are unsound, for	9
(a) The fact that the notes were worthless when acquired is immaterial	9
(b) The fact that no cash was involved in the transaction is immaterial	12
(c) The Commissioner under Section 212 of the Revenue Act of 1926 has no power to deprive the petitioner of his specific right to a deduction from income conferred by Section 214(a) of that Statute	18
(d) The treatment of the transaction urged by the petitioner most accurately reflects the true situation	20
POINT III—Were an additional ground necessary to permit deduction it might be found on the theory of a business loss sustained by petitioner and deductible under Section 214(a)(4)(5) of the Revenue Act of 1926	21
CONCLUSION—For the foregoing reasons the judgment of the Circuit Court of Appeals for the Second Circuit should be reversed	23
STATUTES—	
Revenue Act of 1926, Section 214(a)	4
Revenue Act of 1926, Section 212	19
Neg. Instr. Law of New York, Section 202	6
Neg. Instr. Law of New York, Section 304	7

CASES— Page

Beekman, Charles K. v. Commissioner, 17 B. T. A., 643 11
Collin, Charles A., Appeal of, 1 B. T. A., 305 11
Davis, S. R., v. Commissioner, 9 B. T. A., 755. (Reversed by Circuit Court of Appeals) 14
Gerseta Corporation v. Gramatan National Bank of Bronxville (1923) 205 A. D., 868 7
Gould v. Gould (1917) 245 U. S., 151 12
Hayes, J. Noble v. Commissioner, 7 B. T. A., 936 11
Jackson v. Moore (1904) 94 A. D., 504 7
Kepner v. United States, 195 U. S., 100 19
Kimberly, Matter of, 150 N. Y., 90 7
Klatzl, Matter of (1915) 216 N. Y., 83 7
McGinnis, Bob H., Appeal of, 4 B. T. A., 209 16
McGregor v. Walters (1928) 133 Misc., 24 8
Mitten v. Commissioner of Internal Revenue, 11 B. T. A., 731 8
Newton, et al., v. Commissioner of Internal Revenue, 7 B. T. A., 1153 8
Pittsburgh-Westmoreland Coal Co. v. Kerr (1917) 220 N. Y., 137 7
Plant v. Walsh, 280 Fed. 722 10
Poor, Henry V., v. Commissioner, 11 B. T. A., 781 11
Sass, Maurice, v. Commissioner, 7 B. T. A., 557; 12 B. T. A., 156; 17 B. T. A., 261 15
Simons, Howard J., Appeal of, 1 B. T. A., 351 11
Stephenson, E. B., v. Commissioner of Internal Revenue, 43 Fed. (2d) 348 16
Weis, A. W. D., v. Commissioner, 13 B. T. A., 1284 ..... 14, 20
Worcester Bank & Trust Co., et al., v. Commissioner, 13 B. T. A., 630 10

Argued by
HENRY T. DORRANCE

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 8-10) is reported in 17 B.T.A., 263. The opinion of the Circuit Court of Appeals is reported in 42 Fed. (2d) 158.

JURISDICTION

The jurisdiction of the Court is invoked under Section 240(a) of the Judicial Code.

The judgment of the Circuit Court of Appeals was entered June 9, 1930 (R. 18). A petition for re-hearing was denied July 7, 1930 (R. 18). The petition for a writ of certiorari was filed August 14, 1930 (R. 19) and the order allowing certiorari on October 20, 1930 (R. 19).

STATEMENT OF CASE

(a) The case involves an alleged deficiency in income tax for the year 1925 in the amount of $3,378.89 (R. 2).

(b) The facts are undisputed (R. 7-8). They may be summarized as follows:

Prior to 1922 — Petitioner and William Ainsworth were doing business as co-partners under the name of "Electric Refrigeration Company."

1922 — A corporation was organized under the name "Electric Refrigeration Co. Inc." which took over all the assets and assumed all the liabilities of the partnership among which were notes of $25,419.65.

1922-1925 — The corporation continued in business; it substituted its own notes for the old partnership notes and issued in addition, notes in the amount of $19,375.25. In 1925 prior to the dissolution, it had notes at the Citizens Trust Company of Utica, N. Y., for around $45,000.00. These notes were made by the corporation, but all of them were endorsed by the petitioner and Ainsworth.

1925 — The corporation was discontinued with no assets; the Bank called the notes above listed; the petitioner and Ainsworth went to the Bank in December, turned over all the cash that the Company had in the amount of some $600.00, which left a balance due on the notes of $44,800.00; gave their personal notes to the Bank in the amount of $44,800.00; and took up the notes of the corporation which were surrendered to them by the Bank and marked "Paid."

It was of course definitely ascertained in 1925 that the notes of the corporation which were taken up were absolutely worthless, the assets of the corporation being insufficient on dissolution in that year to pay any amount on the notes except for $600.00 and the notes being destroyed by the petitioner who regarded his one-half, $22,400.00, as a bad debt or loss for the year 1925.

The petitioner is on a cash basis and not on an accrual basis.

(c) From an income tax standpoint there are two possibilities as to the treatment of the transaction above outlined:

1st — The first alternative is to allow as a bad debt deduction the petitioner's one-half of the notes of the corporation which he was obliged to take up as aforesaid and which were ascertained to be worthless and were charged off in 1925. This treatment of the transaction is the one primarily urged and relied on by the petitioner before the Board of Tax Appeals, the Circuit Court of Appeals and before this Honorable Court. This contention however was almost entirely ignored both by the Board of Tax Appeals and the Circuit Court of Appeals.

2nd — The second alternative is to treat the transaction as one giving rise to a business loss measured by the new personal notes given. This alternative occupied most of the attention of the lower courts despite petitioner's efforts to direct that attention to the first alternative. The petitioner will briefly call this second alternative to the attention of this Court, but as already pointed out, the first alternative is primarily relied upon, petitioner feeling that his right to the deduction is clearly justifiable under the provisions of law thereto applicable.

(d) The statutory provisions involved are:

Revenue Act of 1926, Section 214 (a)

"Sec. 214 (a)—In computing net income there shall be allowed as deductions:

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

(7) Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part."

The Act of 1926 is made applicable to the year 1925 by Section 286.

SPECIFICATION OF ERRORS

The petitioner asks for a reversal of the judgment of the Circuit Court of Appeals on the ground that it is contrary to law, being based on a failure and refusal to allow petitioner the hereinbefore mentioned deduction from income in determining his income tax, to which deduction petitioner is entitled under the Revenue Act of 1926.

OUTLINE OF ARGUMENT

In support of his prayer that the judgment of the lower Court be reversed petitioner will advance the following points:

Point I. *The petitioner is expressly entitled by the provisions of Section 214(a)(7) of the Revenue Act of 1926 to deduct from income as a bad debt his share of the notes of the Electric Refrigeration Co. Inc., which he acquired, ascertained to be worthless and charged off in 1925, for*

(a) On payment to the Bank the petitioner and Ainsworth became owners of the notes of the corporation which they had a right to enforce against the corporation;

(b) The notes thus acquired were ascertained to be worthless in 1925 and were charged off in that year.

Point II. *The arguments of the learned Solicitor General, some of which were approved by the lower Courts, are unsound, for*

(a) The fact that the notes were worthless when acquired is immaterial;

(b) The fact that no cash was involved in the transaction is immaterial;

(c) The Commissioner under Section 212 of the Revenue Act of 1926 has no power to deprive the petitioner of his specific right to a deduction from income conferred by Section 214(a) of that Statute;

(d) The treatment of the transaction urged by the petitioner most accurately reflects his income.

Point III. *Were an additional ground necessary to permit deduction it might be found on the theory of a business loss sustained by petitioner and deductible under Section 214(a)(4)(5) of the Revenue Act of 1926.*

ARGUMENT

POINT I

The petitioner is expressly entitled by the provisions of Section 214(a)(7) of the Revenue Act of 1926 to deduct from income as a bad debt his share of the notes of the Electric Refrigeration Co. Inc., which he acquired, ascertained to be worthless and charged off in 1925, for

(a) On payment to the bank, the petitioner and Ainsworth became owners of the notes of the corporation which they had a right to enforce against the corporation.

It is to be borne in mind that the old partnership notes were taken up and that in 1925 all of the notes were those made by the corporation on which Ainsworth and Eckert, who had endorsed for the accommodation of the corporation, were secondarily liable.

While the rule may not be the same in all states, in New York State, it has long been settled that where, in such a case, the endorsers pay such a note, the note is not discharged but the parties paying it become the owners of the note and may enforce it against the maker, being subrogated to all rights of the holders.

Negotiable Instruments Law of New York, Section 202.

> "Right of party who discharges instrument. Where the instrument is paid by a party secondarily liable thereon, it is not discharged; but the party so paying it is remitted to his former rights as regards all prior parties, and he may strike out his own and all subsequent indorsements, and again negotiate the instrument * * *."

Negotiable Instruments Law of New York, Section 304.

"Effect on subsequent parties where bill is paid for honor. Where a bill has been paid for honor all parties subsequent to the party for whose honor it is paid are discharged, but the payer for honor is subrogated for, and succeeds to, both the rights and duties of the holder as regards the party for whose honor he pays and all parties liable to the latter."

Pittsburgh-Westmoreland Coal Co. v. Kerr, (1917) 220 N. Y., 137.

Gersetz Corporation v. Gramatan National Bank of Bronxville (1923) 205 A. D., 868.

Therefore, when the Bank marked the notes paid, and surrendered them to the taxpayer and Ainsworth, they became the sole and legal owners of the same and had the right to enforce them against the corporation.

Having secured the notes of the company by giving their joint personal notes, the ownership of the corporate notes was of course a tenancy in common under Section 66 of the Real Property Law of the State of New York which is held to apply to personal property as well as real property;

Matter of Kimberly, 150 N. Y., 90;

and each was the owner of an undivided one-half;

Jackson v. Moore (1904) 94 A. D., 504.

Matter of Klatzl (1915) 216 N. Y., 83 at 87 and 88.

McGreggor v. Walters (1928) 133 Misc., 24 at 25.

and each naturally wrote off his one-half as a bad debt—which he would naturally assume he had a perfect right to do.

(b) The notes thus acquired were ascertained to be worthless in 1925 and were charged off in that year.

It was of course definitely ascertained in 1925 that the notes were worthless, the corporation being liquidated in that year.

The taxpayer regarded and treated his share of the notes as a bad debt in 1925, destroying the notes as worthless in that year. It is true that there was no charging off on books of account, but this is not necessary where, as in the present case, no books of account are kept by the taxpayer.

Newton, et al., v. Commissioner of Internal Revenue, 7 B. T. A., 1153 at 1155:

"Since the petitioners kept no books of account the requirement that the bad debts be charged off before they can be claimed as a deduction does not apply to them."

Mitten v. Commissioner of Internal Revenue, 11 B. T. A., 731 at 733:

"As he kept no books of account no formal book entry or charge-off as mentioned in the statute was necessary in his case. See Huning Mercantile Co., 1 B. T. A., 130; Charles A. Collins, 1 B. T. A., 305; United States Tool Co., 3 B. T. A., 492."

POINT II

The arguments of the learned Solicitor General, some of which were approved by the lower Courts, are unsound, for

(a) The fact that the notes were worthless when acquired is immaterial.

The Circuit Court of Appeals dismissed the contention that the petitioner was entitled to a deduction for a bad debt in the following summary manner (R. 17):

> "Nor is the taxpayer entitled to a deduction under Clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it."

The Court cited no authorities for this statement and we believe that the statement is not supported by a reading of the Statute and a perusal of the decisions that have arisen thereunder.

It is true that the notes were worthless when acquired—but the Statute imposes no requirement that they be of value when acquired. Here again the Court is confusing a bad debt deduction with a loss deduction.

The petitioner was obliged to take up and did take up these notes. He acquired said notes at and for their face value; he ascertained said notes to be worthless; and he wrote them off in the year 1925. It is submitted that these facts are sufficient to warrant deduction under Section 214(a) of the Revenue Act of 1926 which provides that in computing net income there shall be allowed as deductions:

> "7. Debts ascertained to be worthless and charged off within the taxable year * * *"

A somewhat analogous situation was considered in:

E. B. Stephenson v. Commissioner of Internal Revenue, 43 Fed. (2d) 348,

where the taxpayer was allowed to take deduction with respect to advances to a pool to be used for taking up from the bank certain notes that were largely worthless at the time when acquired.

Likewise, deduction was allowed on account of stock worthless when purchased:

Worcester Bank & Trust Co., et al., v. Commissioner, 13 B. T. A., 630.

It has been held that a tax payer may write off as a bad debt for the year 1913 bonds that were worthless in that year, even though they may have become worthless prior to March 1st, 1913.

Plant v. Walsh, 280 Fed., 722 at 724.

"The defendant contends that the taxpayer is entitled to charge off only the amount of the actual value of the bonds on March 1, 1913; that the burden is on the taxpayer to establish this amount, and since there is no evidence to show what the bonds were actually worth on that date the entire deduction should be disallowed.

"The plaintiff contends that all the statute requires him to prove is that the debt was ascertained to be worthless and charged off within the year 1913. This he has done by the undisputed evidence. The effect of so construing the statute may be to permit the taxpayer to deduct five-sixths of a loss accruing prior to

the commencement of the taxable period, so that the return will not reflect his entire income for that period. But Congress has the right to do this, and has done it if the statute is to be literally construed. In case of doubt a tax law should be construed in favor of the taxpayer. *Gould v. Gould*, 245 U. S. 151, 38 Sup. Ct. 53, 62 L. Ed. 211. Therefore I conclude that the taxpayers contention should be sustained."

The respondent in the Circuit Court of Appeals, taking the position that no write-off can be had if the debt was worthless at the time of acquisition, attempts to justify this position by the argument that the words in the Statute "charged off" necessarily imply that the debt must first be "charged on" and cites in support of this contention the following cases:

Appeal of Charles A. Collin, 1 B. T. A., 305.

Henry V. Poor v. Commissioner, 11 B. T. A., 781; Affd. 30 Fed. (2d) 1019.

Charles K. Beekman v. Commissioner, 17 B. T. A., 643.

J. Noble Hayes v. Commissioner, 7 B. T. A., 936.

Appeal of Howard J. Simons, 1 B. T. A., 351.

None of these cases are here applicable, the cases cited merely holding that a taxpayer cannot charge off as a bad debt income which he expected to receive unless he had shown such income in prior returns—an obviously fair and logical ruling.

As already stated, there is nothing in the Statute that indicates that the debt must be of value at the time it is acquired in order to justify its being written off as a bad debt.

The Statute requires that the taxpayer shall be the owner of the debt; that it shall be ascertained to be worthless; that it shall be written off. All requirements are here present; and there is no justification for adding a further requirement, as the Commissioner seeks to do.

But were there ambiguity in the Statute, it should be resolved in favor of the taxpayer under the well settled doctrine of this Court.

Gould v. Gould (1917), 245 U. S., 151 at page 153.

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government and in favor of the citizen. *United States v. Wigglesworth*, 2 Storey, 369; *American Net & Twine Co. v. Worthington*, 141 U. S., 468, 474; *Benzinger v. United States*, 192 U. S., 38, 55."

(b) The fact that no cash was involved in the transaction is immaterial.

We believe that the deductibility of the amount in dispute would be conceded by the Commissioner if cash had actually passed when the corporation's notes were taken up.

In other words, we understand that had the procedure been one whereby the taxpayer and Ainsworth first gave their notes to the Bank, deposited the proceeds in their checking account, and at once drawn checks to the Bank and taken up the notes in question, the Commissioner would concede the propriety of the deduction, the only objection being based on the absence of cash.

We think that this objection rests upon a mis-apprehension of the taxpayer's position, and that in the present case, the absence of cash does not prevent deductibility for the following reasons:

1. *We are, under this Point I, claiming a bad debt deduction on the notes of the corporation acquired as aforesaid—not a business loss represented by the new personal notes given.*

This is the vital distinction to be kept in mind.

We do not claim a business loss represented by the new personal notes—we claim a deduction for the corporation's notes, ascertained to be worthless in 1925.

2. *In such a case, the presence of cash is not required by the authorities or by a reasonable construction of the Statute.*

We believe that the lower Courts have confused this case with the cases where a taxpayer on a cash basis attempts to claim a loss for notes given by him but not yet paid.

Without discussing the merits of such cases, in any event they have no application here, where the deduction is based on the notes acquired.

Under the authorities, the taxpayer is entitled to deduct his share of the worthless notes in 1925.

To the best of our knowledge there are only three cases in which this question has been squarely considered—and all of them are decisive of the question in our favor.

S. R. Davis v. Commissioner, 9 B. T. A., 755, Reversed by the Circuit Court of Appeals for the Seventh Circuit October 24, 1928. (Vol. I 1931 C. C. H. Tax Service, Par. 207, 342).

In the case cited, the petitioner was the guarantor of certain notes given by the Multitone Manufacturing Co. This company went into the hands of a receiver in 1921. The petitioner then gave to the payee of the notes his own notes and received the notes upon which he was guarantor. He made a claim against the receiver of the corporation for the amount of the notes guaranteed by him and in 1921 received a final liquidating dividend from the Multitone Manufacturing Company. It was held by the Board that since the petitioner made his income tax return for 1921 on a cash receipts and disbursements basis, he was not entitled to deduct from the gross income of that year the amount of the notes given but not paid in that year. This holding was reversed by the Circuit Court of Appeals for the Seventh Circuit on October 24, 1928.

The second case in which the point here involved is considered is:

A. W. D. Weis v. Commissioner, 13 B. T. A., 1284.

In the case cited, the petitioner and one Morgan conducted a lumber company which gave to the bank its notes. In 1919 the bank called the notes and the petitioner gave

his personal note for the amount of the principal and interest due on the company's note which he took up. The business was wound up in 1919 and it was then ascertained that the company would have little or no assets to apply on its note. The personal note given by the petitioner was not paid until 1923. Nevertheless the petitioner was allowed to deduct in the year 1919 the amount of the principal and interest due on the corporate notes which he had taken up.

The third case in which the point here at issue has been considered is that of

> *Maurice Sass v. Commissioner*, 7 B. T. A., 557; Modified in 12 B. T. A., 156; Affd. in 17 B. T. A., 261.

Here the petitioner claimed as a deduction the amount due on notes guaranteed by the petitioner which he had been obliged to take up and for which he had substituted his own notes not paid in the taxable year. The final holding of the Board was that the deduction could not be taken because it was not shown that the notes taken up were worthless in the year in which taken up. The Board said in part in 17 B. T. A., at 263:

> "* * * petitioner has not shown that he is entitled to a deduction of $19,253.54 by reason of the fact that he gave his note in that amount to the bank in the year 1919. Even under the petitioner's claim, in order to become entitled to a deduction of this amount, it is incumbent upon him to show by a preponderance of the evidence that the obligations of the borrowers, whose notes he had guaranteed, were worthless in the year 1919 and this he has failed to do. The mere fact that the bank called upon peti-

tioner to take care of the unpaid notes of others, the payment of which he had guaranteed, and that he gave to the bank his promissory note, does not of itself prove that he has sustained a deductible loss in the year in which he gave his note. When petitioner gave his note to the bank he was subrogated to all rights of the bank against the makers of the notes remaining unpaid at that time and there is not sufficient evidence in this record to convince the Board that the notes given to the bank and taken over by petitioner were worthless and uncollectible in the taxable year. This fact distinguished this case from the proceeding of *S. R. Davis*, 9 B. T. A., 755, and *A. W. D. Weis*, 13 B. T. A., 1284."

But in the case at bar there is proof — and in fact no contention to the contrary—that the notes of the corporation which the petitioner took up were worthless and were ascertained to be worthless in the year 1925; the Board finding that "subsequently in 1925 the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600.00"; and the petitioner and Ainsworth being obliged to take care of the rest by giving their note for the deficiency of $44,800.00.

Certainly if a taxpayer purchases stock, giving his note in payment, and later sells the stock at a loss, he may deduct the loss, though the note be not paid at that time. So it is held that where merchandise is bought and sold during the taxable year, though not fully paid for until a subsequent year, it is nevertheless to be included in purchases for the taxable year in computing income of one who is on a cash basis.

Appeal of Bob H. McGinnis, 4 B. T. A., 209.

So here, when the taxpayer acquires the corporation's notes, and these are ascertained to be worthless and charged off, the right to a deduction therefor would seem to be clear.

There is nothing in the Statute that requires the payment of cash, or that indicates any such requirement; but were there any ambiguity it is to be resolved in favor of the taxpayer, under the rule of law already stated.

3. *To insist on the presence of cash is to insist on a meaningless form.*

The situation, effect and result of the transaction is exactly the same as if the petitioner and Ainsworth in 1925 had gone to the bank, given their notes, deposited the proceeds in their accounts, checked it out to the bank and taken up the notes of the corporation.

The mode adopted was merely a short cut of this transaction; the same purpose was served and the same result achieved.

It would seem unnecessary to insist on a mere matter of useless form; the result would seem to be the proper test.

We shall not, however, pursue this angle further, since if the Commissioner's sole requirement is the presence of tangible consideration passing from the taxpayer, this requirement can readily be met.

4. *As to* $25,000.00 *of the notes, the petitioner has actually paid out tangible consideration.*

The taxpayer and Ainsworth in 1922 had partnership property and partnership liabilities, among them notes in the amount of $25,000.00.

They parted with the property in 1922 in return for the assumption of the liabilities.

In other words, the partners conveyed their property in return for the corporation's promise to pay the liabilities, and hold the partners indemnified.

This obligation of the corporation was represented at least up to $25,000.00, by the notes on which the corporation was primarily liable as maker and the individuals secondarily liable as indorsers; and with respect to which the corporation was bound to hold the indorsers harmless not merely by the express agreement of 1922, but also by the implied obligation imposed by law.

This obligation, represented by these notes, became worthless in 1925.

The petitioner had transferred his property in 1922 for this obligation. He had paid for it in tangible consideration in 1922. If it becomes worthless in 1925, why cannot he deduct it?

The suggestion was made that when the individuals in 1925 gave their notes, they were remitted to their 1922 position. That is not so—their liabilities have returned, but their properties have not.

"(e) The Commissioner under Section 212 of the Revenue Act of 1926 has no power to deprive the petitioner of his specific right to a deduction from income conferred by Section 214(a) of that Statute.

Upon the arguments in the Courts below there was mentioned the authority of the Commissioner in respect to the computation of income of a taxpayer under

Revenue Act of 1926, Section 212.

"Sec. 212(a) In the case of an individual the term "net income" means the gross income as defined in Section 213, less the deductions allowed by Sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income."

It would seem that the above entitled section confers no right on the Commissioner to make the adjustment attempted in the case at bar.

In the first place, as will be pointed out hereafter, the method employed by the taxpayer most clearly reflects his income and his financial situation.

In the second place, a general statutory provision such as Section 212(b) has never been held to confer authority on the Commissioner to deprive a taxpayer of a deduction, the right to which is specifically given under Section 214 of the same act.

It is universally held that general language does not limit a specific right conferred by clear and specific language. The rule is so well known as to require no citation; but it is aptly phrased in:

Kepner v. United States, 195 U. S. 100 at 125.

"It is a well settled principle of construction that specific terms covering the given subject matter will prevail over general language of the same or another statute which might otherwise prove controlling."

(d) The treatment of the transaction urged by the petitioner most accurately reflects the true situation.

It was in the year 1925 that it was definitely ascertained that the taxpayer would be obliged to take up the notes of the corporation. It was in the same year that these notes were taken up and acquired; and it was in the same year that these notes were written off as worthless. It was in the year 1925 that it was definitely ascertained that the taxpayer had sustained this loss; it was in that year that his net worth was correspondingly reduced; and it most accurately reflects the true situation to show this transaction in the year in which it occurred.

To postpone the deduction until cash is paid might mean the distortion of income, and by a juggling of checks and notes a taxpayer might shift the loss to any year he should see fit to select. The method urged by the petitioner on the contrary most clearly reflects the true status of the affairs. This is pointed out in the decision already referred to.

A. W. D. Weis v. Commissioner of Internal Revenue, 13 B. T. A., 1284 at 1289.

"We are of the opinion that all the losses here in question were sustained in the years in which the several investments became worthless. In such respective years each of the deals became a closed transaction and the petitioner's net assets were reduced in the amount of the loss sustained. It is not material

whether such losses were met by the payment of cash from funds in hand or with cash borrowed from the bank and evidenced by notes payable in a subsequent year. The loss had been sustained and the transaction had been closed by a cash payment. The use of the petitioner's credit to secure funds from the bank was a new and different deal and had no more to do with the petitioner's tax liability than any other borrowing that he did in the taxable year. *Cf. Bob H. McGinnis*, 4 B. T. A., 209.

If the deductions herein claimed are allowed for the respective taxable years in which the losses occurred, correct income and true tax liability for such years may be determined. If postponed, manifestly income of the years to which they are eventually applied and to which they have no proper application will be distorted."

POINT III

Were an additional ground necessary to permit deduction it might be found on the theory of a business loss sustained by petitioner and deductible under Section 214(a)(4)(5) of the Revenue Act of 1926.

As already stated, the petitioner's primary contention is that he should be allowed a bad debt deduction on his one-half of the notes of the corporation which he was obliged to take up as aforesaid and which were ascertained to be worthless and charged off in 1925.

There is however another alternative—the treatment of the transaction as one giving rise to a business loss measured by the new personal notes given.

Revenue Act of 1926, Sections 214(a)(4)(5).

"Sec. 214(a) In computing net income there shall be allowed as deductions:

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

We believe that the only objection to a deduction under the foregoing statutory provisions is the absence of cash appearing in the transaction.

We can see nothing in the Statute that requires the presence of cash. The transaction was closed in the year 1925; the various matters were completed; and it was definitely ascertained at that time that the petitioner would sustain the losses in question.

It is true that no cash was paid at that time; but it is also true that there is nothing in the Statute to indicate that this requirement is necessary.

We shall not however pursue this argument further since we believe the petitioner's right to the deduction is established under Points I and II, *supra*, relating to the deduction as a bad debt of the notes taken up by the petitioner.

CONCLUSION

For the foregoing reasons the judgment of the Circuit Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

C. R. DEWEY,
HENRY T. DORRANCE,
Counsel for Petitioner,
Office and P. O. Address,
First National Bank Bldg.,
Utica, New York.